

## Message Text

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PAGE 01 LONDON 05581 01 OF 03 041901Z  
ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 CIAE-00 DODE-00 PM-04 H-01  
INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02  
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R 041847Z APR 77  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC 2343  
INFO AMEMBASSY ANKARA  
AMEMBASSY ATHENS  
AMEMBASSY BERN  
AMEMBASSY BONN  
AMEMBASSY BRUSSELS  
AMEMBASSY CANBERRA  
AMEMBASSY COPENHAGEN  
AMEMBASSY DUBLIN  
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AMEMBASSY LUXEMBOURG  
AMEMBASSY MADRID  
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AMEMBASSY OTTAWA  
AMEMBASSY PARIS  
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PAGE 02 LONDON 05581 01 OF 03 041901Z

C O N F I D E N T I A L SECTION 01 OF 03 LONDON 05581

E.O. 11652: GDS  
TAGS: PGOV, PINT, ELAB. EGEN, UK. PFOR  
SUBJECT: BRITAIN IN MARCH: A POLITICAL DEAL AND A  
RESPONSIBLE BUDGET

REF: LONDON 3719

SUMMARY. MARCH WAS THE MONTH OF THE GOVERNMENT'S "DEAL" WITH THE LIBERAL PARTY, A POLITICAL EVENT WHICH COULD ULTIMATELY EITHER PROVE MOMENTOUS FOR THE BRITISH BODY POLITIC OR FALL AWAY AS MERELY ANOTHER TRANSIENT STEP IN THE MARCH OF TIME. THIS ARRANGEMENT, UNDER WHICH THE LIBERAL PARTY AGREED TO SUSTAIN THE LABOR GOVERNMENT IN OFFICE AT LEAST THROUGH NEXT AUTUMN, HURT BOTH PARTIES IN A FIRST BY-ELECTION TEST AT MONTH'S END. ECONOMIC INDICATORS WERE MODERATELY GOOD AND CHANCELLOR HEALEY PRESENTED A CAUTIOUS BUDGET WITH A LITTLE SOMETHING FOR EVERYONE. IT WAS A REASONABLE EFFORT TO CONTINUE THE GOVERNMENT'S CHOSEN ECONOMIC POLICY, RATHER THAN A SHORT-TERM BID FOR VOTER SUPPORT. ANGLO-AMERICAN RELATIONS PROSPERED. END SUMMARY.

1. MARCH BEGAN WITH BRITAIN'S LABOR GOVERNMENT HUNKERING DOWN FOR A PROLONGED PERIOD OF MINORITY RULE BY PULLING BACK FROM WHAT LITTLE REMAINED OF IDEOLOGICALLY CONTROVERSIAL LEGISLATION. PUBLICLY JAUNTY TALK CENTERED ON STILL BEING ABLE EFFECTIVELY TO GOVERN -- I.E., STRUGGLE TO ACHIEVE ECONOMIC GROWTH, CUT INFLATION AND UNEMPLOYMENT -- EVEN IF UNABLE TO LEGISLATE IN CONTENTIOUS AREAS. CALLAGHAN'S HOPES OF AVOIDING PARLIAMENTARY CRISES WHICH COULD ENDANGER HIS SURVIVAL WERE HIGH.

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PAGE 03 LONDON 05581 01 OF 03 041901Z

2. THIS SCENARIO PROVED OVER-OPTIMISTIC. IT HAD NOT TAKEN SUFFICIENTLY INTO ACCOUNT THE GOVERNMENT'S EARLIER INABILITY TO IMPOSE A GUILLOTINE ON THE DEVOLUTION BILL AND THE CONSEQUENT DETERMINATION OF THE SEVERAL NATIONALIST PARTIES TO SCUTTLE THE GOVERNMENT AS SOON AS POSSIBLE, OR ITS CAPACITY TO BLUNDER INTO A CRISIS SITUATION.

3. WITH THE AGGRAVATION OF NATIONALIST HOSTILITY ADDED TO THE CHRONIC UNHAPPINESS OF LABOR'S OWN LEFT-WING, THE GOVERNMENT WAS IN NO POSITION TO RISK ASKING FOR POSITIVE PARLIAMENTARY ENDORSEMENT OF ITS PUBLIC SPENDING PLANS. IT BUNGLED THE TACTICS WHICH WERE TO TAKE IT AROUND THAT LITTLE EMBARRASSMENT IN THE HOUSE AND WOUND UP FACING AN ANGRY COMMONS AND A CONSERVATIVE MOTION OF NO CONFIDENCE THAT THREATENED TO CARRY. ELECTION FEVER FLARED IN TORY RANKS.

4. TOUGH BARGAINING LED TO AN ARRANGEMENT BETWEEN THE

LABOR GOVERNMENT AND LIBERAL PARTY WHICH AVOIDED THE  
EARLY ELECTION THAT NEITHER PARTY WANTED. ALONG WITH A  
FEW SPECIFICS, THE LIBERALS GOT MAINLY AN AGREEMENT TO  
ESTABLISH GENERAL CONSULTATIVE MECHANISMS BETWEEN THEM-  
SELVES AND THE LABOR GOVERNMENT ON POLICY AND LEGIS-  
LATIVE PROPOSALS. IN RETURN, THEY AGREED TO SUPPORT THE  
GOVERNMENT ON ANY CONFIDENCE VOTES THROUGH THE END OF THE  
CURRENT PARLIAMENTARY SESSION IN THE FALL, WITH THE  
CONTRACT RENEWABLE SHOULD BOTH SIDES DESIRE TO CONTINUE.

5. WOULD THIS GOVERNMENT/LIBERAL DEAL, HAILED BY SOME  
AND DENOUNCED BY OTHERS, PROVE A LANDMARK HARBINGER OF  
STRUCTURAL CHANGE FOR THE BRITISH BODY POLITIC AND ALL

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PAGE 01 LONDON 05581 02 OF 03 041904Z  
ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 CIAE-00 DODE-00 PM-04 H-01  
INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02  
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R 041847Z APR 77  
FM AMEMBASSY LONDON  
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PAGE 02 LONDON 05581 02 OF 03 041904Z

C O N F I D E N T I A L SECTION 02 OF 03 LONDON 05581

THAT IMPLIES FOR THE SOCIAL FABRIC, OR MERELY A TEMPORARY STOPGAP THAT IS JUDGED UNACCEPTABLE BY THE ELECTORATE, HURTS BOTH PARTIES, AND DISAPPEARS? ONLY TIME COULD TELL THE CONSEQUENCES OF AN ARRANGEMENT WHICH EVEN ITS PROPONENTS AGREE IS FRANKLY EXPERIMENTAL. ON BALANCE, WE ARE DUBIOUS THAT IT PORTENDS ANY MAJOR CHANGES.

6. A FIRST TEST -- AND ONE THAT PROBABLY CAME MUCH TOO EARLY TO BE MEANINGFUL -- WAS THE MARCH 31 BY-ELECTION TO FILL ROY JENKINS' "SAFE" SEAT IN STECHFORD. THE CONSERVATIVES WON A STUNNING VICTORY, AIDED AT LEAST IN PART BY THE REVULSION MANY LABOR VOTERS FELT AGAINST THE DEAL, ALTHOUGH THE ECONOMY, THE BUDGET AND RACISM WERE ALSO SIGNIFICANT FACTORS. THE LIBERALS WERE ALSO CLOBBERED. PARADOXICALLY, THIS NEGATIVE FIRST PRO-NOUNCEMENT BY THE ELECTORATE CAN ONLY REINFORCE BOTH PARTIES' DETERMINATION TO PERSIST IN THE ARRANGEMENT. THE CALLAGHAN GOVERNMENT STILL NEEDS TIME FOR THE ECONOMY TO IMPROVE. DAVID STEEL'S LIBERALS MUST HAVE TIME TO DEMONSTRATE THAT THEY HAVE GAINED RELEVANCE AND INFLUENCE. IN STECHFORD, BOTH PARTIES HAD TO PAY FOR A BARGAIN WHILE IT WAS STILL TOO EARLY TO REAP THE HOPED-FOR BENEFITS. DESPITE CONSERVATIVE EUPHORIA AND READY DOOM-SAYING BY THE MEDIA, IT IS TOO EARLY TO WRITE OFF THE GOVERNMENT'S ARRANGEMENT WITH THE LIBERALS.

7. IN THE ECONOMIC REALM, DENIS HEALEY APPEARED BEFORE AN EXPECTANT HOUSE OF COMMONS MARCH 29 TO DELIVER A BUDGET WITH SOMETHING IN IT FOR EVERYONE. TRUE TO PREVIOUS FORM, HIS PROPOSALS WERE TINGED WITH CAUTION.  
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PAGE 03 LONDON 05581 02 OF 03 041904Z

THERE WOULD BE 2.3 BILLION POUNDS IN INCOME TAX REDUCTIONS, BUT A BILLION OF THIS WOULD BE CONTINGENT ON TRADE UNION AGREEMENT TO FURTHER THOUGH INTENTIONALLY UNDEFINED WAGE RESTRAINT. MOREOVER, COMMITMENTS TO THE IMF PLUS THE FEAR OF SHARP INCREASES IN RETAIL PRICES RESULTANT FROM ANY RISE IN VALUE ADDED TAX MOVED THE CHANCELLOR TO LIMIT INCREASES TO EXCISE TAXES ON TOBACCO, GASOLINE, AND CAR REGISTRATION. TOTALLING 0.8 BILLION POUNDS, THE EXCISE TAX HIKES REDUCED THE IMPACT OF THE TAX CUT TO 1.5 BILLION POUNDS.

8. THE CHANCELLOR WAS EXPANSIVE ON THE NEW CLIMATE OF CONFIDENCE CREATED SINCE THE DECEMBER ACCORD WITH THE IMF. HE FELT ECONOMIC PROSPECTS HAD BRIGHTENED THOUGH THE LEVEL OF GROWTH DEPENDED HEAVILY ON THE RATE OF EXPANSION OF BRITAIN'S MAJOR TRADING PARTNERS SINCE EXPORTS WERE A KEY TO ECONOMIC RECOVERY. HE HELD OUT THE HOPE OF SINGLE-DIGIT INFLATION (READ 9.5 PER CENT )BY JUNE 1978. A RELATIVELY STABLE POUND COUPLED WITH THE FAVORABLE IMPACT OF THE SECOND AND THIRD YEAR OF WAGE RESTRAINT WOULD BRING THIS ABOUT.

9. THE BUDGET MEASURES SHOULD ADD LITTLE STIMULUS TO THE ECONOMY IN 1977 WITH THEIR FULL IMPACT RAISING THE RATE OF GROWTH LESS THAN ONE PER CENT BY THE END OF 1978. BRITAIN'S IMF COMMITMENTS ARE NOT JEOPARDIZED. MOST INTERESTING IS THE POLITICAL COMPLEXION OF THE BUDGET PROPOSALS. THE CONDITIONAL TAX CUT HAS AGAIN BEEN HELD OVER THE HEADS OF ORGANIZED LABOR AS A MEANS OF PRESSURING THEM INTO ACCEPTING A FURTHER YEAR OF WAGE RESTRAINT. THE TAX CUTS THEMSELVES HAVE BEEN TAILORED TO PROVIDE BENEFIT BOTH TO THOSE AVERAGE AND NEAR-

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PAGE 01 LONDON 05581 03 OF 03 041906Z  
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PAGE 02 LONDON 05581 03 OF 03 041906Z

C O N F I D E N T I A L SECTION 03 OF 03 LONDON 05581

AVERAGE INCOME EARNERS WHO HAVE SEEN PAY DIFFERENTIALS  
ERODED BY THEIR FIRST TWO YEARS OF FLAT RATE WAGE  
INCREASES AND TO THOSE IN MIDDLE MANAGEMENT WHOSE REAL  
INCOMES HAVE FALLEN SHARPLY OVER THE LAST THREE YEARS.

10. ORGANIZED LABOR ONCE AGAIN FINDS ITSELF IN AN UN-  
COMFORTABLE SPOT OVER CONDITIONAL RELIEF. NEGOTIATIONS  
BETWEEN HMG AND THE TUC WILL BE COMPLEX AND PERHAOS  
ACRIMONIOUS. HOWEVER, A COMPROMISE OF SOME KIND SEEMS  
PROBABLE. ANTICIPATION OF SUCH AN OUTCOME MAY HAVE  
CONTRIBUTED TO THE FAVORABLE REACTION IN THE FINANCIAL  
COMMUNITY TO WHAT IT VIEWS AS A RESPONSIBLE FISCAL

PROGRAM.

11. ECONOMIC INDICATORS APPEARING DURING MARCH TOOK ON A HEALTHIER TONE WITH INDUSTRIAL PRODUCTION RISING 1.0 PER CENT IN JANUARY. UNEMPLOYMENT DECLINING SLIGHTLY IN MARCH FOR THE SECOND MONTH IN A ROW, AND A SMALL CURRENT ACCOUNT SURPLUS RECORDED IN FEBRUARY. STERLING REMAINED STABLE IN THE \$1.71 - \$1.72 RANGE AS SHORT-TERM INTEREST RATES CONTINUED A DECLINE WHICH HAS SEEN THEM DROP FROM 15 TO BELOW 10 PER CENT OVER A PERIOD OF THREE MONTHS.

12. MARCH MAY OR MAY NOT PROVE TO HAVE BEEN A GOOD MONTH FOR BRITAIN'S LABOR AND LIBERAL PARTIES, FOR A REWEAVING OF BRITAIN'S POLITICAL AND SOCIAL FABRIC, OR FOR BRITAIN'S ECONOMIC FUTURE. IT WAS, HOWEVER, AN UNUSUALLY GOOD MONTH FOR ANGLLO-AMERICAN RELATIONS (DESPITE CONTINUING TOUGH AVIATION NEGOTIATIONS). PRIME MINISTER CALLAGHAN WENT TO WASHINGTON, SECRETARY VANCE CAME TO LONDON, DISCUSSIONS WERE GOOD, AND THE ANGLO-CONFIDENTIAL

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PAGE 03 LONDON 05581 03 OF 03 041906Z

AMERICAN "SPECIAL RELATIONSHIP" WAS REVITALIZED. CALLAGHAN APPRECIATED BEING THE FIRST EUROPEAN LEADER TO MAKE THE OILGRIMAGE TO WASHINGTON TO DISCUSS GLOBAL ISSUES AND ESTABLISH PERSONAL RELATIONS WITH AMERICA'S 'NEW-LOOK" LEADERSHIP. HE LIKED WHAT HE SAW AND HEARD.

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## Message Attributes

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**TAGS:** PGOV, PINT, ELAB, EGEN, PFOR, UK  
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